

DRAFT FOR DISCUSSION ONLY
FINANCIAL TEST ISSUES

A Financial Test submission which substitutes the agreed upon procedures for the negative assurance statement does not comply with regulatory requirements. The Department does not have the discretion to accept an agreed upon procedures statement. The agreed upon procedures standards reflect a lesser degree of scrutiny by the independent accountant and are therefore less stringent than the express requirements of State and federal regulations.

As an authorized hazardous waste management program under RCRA, California is required, inter alia, to be equivalent and consistent with and to provide adequate enforcement of the requirements established by federal and state law. (42 U.S.C. § 6926). As a result, the Department is prohibited by law from accepting the agreed upon procedures in lieu of the negative assurance.¹

California Code of Regulations, title 22, section 66264.143(f) (Financial test and guarantee for closure) provides²:

(1) An owner or operator may satisfy the requirements of this section by demonstrating that he or she passes a financial test as specified in this subsection.

(2) . . .

(3) To demonstrate that this test has been met, the owner or operator shall submit the following items to the Department:

. . .

(C) a special report from the owner's or operator's independent certified public accountant to the owner or operator stating that:

1. the independent certified public accountant has compared the data which the letter from the chief financial officer specifies as having been derived from the independently audited, year-end financial statements for the latest fiscal year with the amounts in such financial statements; and

2. in connection with that procedure, no matters came to the independent certified public accountant's attention which caused that accountant to believe that the specified data should be adjusted.

The statement required of the independent certified public accountant that is set forth in subparagraph (C)(2) is commonly known as the "negative assurance." In September 1995, the Auditing Standards Board³ issued *Statement on Auditing Standards No. 75*

¹ The US/EPA memorandum of February 27, 1997, cited on page 2, was based on an intent to change existing regulations, this has not been done. As a result, the practice announced in said Memorandum is contrary to regulation and cannot be relied upon.

² The same requirement exists as to the financial test for postclosure (Cal. Code Regs., tit. 22, § 66264.145(f)(3)(C)) and for liability (Cal. Code Regs., tit. 22, § 66264.147(g)(3)(C)). The same requirements are also set forth in Chapter 15 for interim status facilities.

³ The Auditing Standards Board is a part of the Financial Accounting Standards Board. The following statement appears on the official website of the Financial Accounting Standards Board:

Since 1973, the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting and

(SAS-75) and *Statement on Standards for Attestation Engagements No. 4* (SSAE-4). The effect of these documents was to prohibit the use of negative assurances in agreed upon procedures engagements.⁴ An agreed upon procedures engagement is one in which the independent accountant and the client enter into a written agreement defining the nature and extent of the accountant's work. A third party may only rely upon the accountant's report if the third party accepts the agreed upon procedures as sufficient.

The US/EPA issued a Memorandum on February 27, 1997, that discussed these changes to accountancy standards. The memorandum concludes as follows:

The Agency intends to change the regulations so that they conform to the new professional auditing standards. Until that rulemaking is completed, in addition to, or in lieu of, a CPA report stating that "no matter came to his attention," EPA will accept a CPA's report describing the procedures performed and related findings, including whether or not there were discrepancies found in the comparison, based on an agreed-upon procedures engagement performed in accordance with AICPA's Statement on Auditing Standards No.75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts or Items of a Financial Statement*. (In an agreed-upon procedures engagement an accountant is engaged by a client to issue a report of findings based on specific procedures performed on the specific items of a financial statement.) The Agency will regard this report as satisfying the requirements of the financial test or corporate guarantee for a special report by an independent CPA on the CFO's letter.

reporting. Those standards govern the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Professional Conduct, as amended May 1973 and May 1979). Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information.

⁴ In October, 2000, SAS No. 75 and SASE No. 4 were withdrawn and respectively replaced by SAS No. 93 (*Omnibus Statement on Auditing Standards*) and SASE No. 10 (*Statements on Standards for Attestation Engagements*). The American Institute of Certified Public Accountants (AICPA), on its website, describes SAS No. 93 and SASE No. 10 as follows:

Withdraws Statement on Auditing Standards (SAS) No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* in order to consolidate the guidance applicable to agreed-upon procedures engagements in professional standards. The guidance currently in SAS No. 75 will be incorporated in Statements on Standards for Attestation Engagements (SSAE) No. 10, *Attestation Standards: Revision and Recodification*. The withdrawal of SAS No. 75 is concurrent with the effective date of SSAE No. 10. SSAE No. 10 is effective for agreed-upon procedures engagements for which the subject matter or assertion is as of or for a period ending on or after June 1, 2001, with earlier application permitted.

To this date no such change in the Subtitle C regulations has been made.⁵

The work performed under an agreed upon procedures methodology is defined and limited by the contract between the independent accountant and the facility ownership. A negative assurance requires the independent accountant to make a more all-encompassing analysis. The result is a methodology that is less stringent than the analysis required by the regulatory standard of negative assurances.

In addition, the agreed upon procedures are not necessarily consistent from one facility and accountancy firm to the next. This factor could easily lead to different treatment of otherwise equivalent facilities, the lack of a clear line for qualification, and the necessity of greater scrutiny by the Department of financial test submissions. One major purpose of the negative assurance requirement is to place the burden of demonstrating compliance with the regulations on the facilities and their accountants. If the Department can no longer rely on a clear standard every submission will need to be examined by an experienced accountant.

The Department has received requests from several facilities that the Department accept an agreed upon procedures letter in satisfaction of California Code of Regulations, title 22, section 66264.143(f)(3)(C)(2). The proposed agreed upon procedures set forth in the requests differed from one another. No procedures at all were set forth in some requests.

In all cases where procedures were disclosed to the Department those procedures were insufficient to provide the level of assurance required by California Code of Regulations, title 22, section 66264.143(f)(3)(C)(2).

⁵ On April 10, 1998, US/EPA did issue regulations authorizing the use of the agreed upon procedures standard for Municipal Solid Waste Landfills. (See 63 FR 17706 re 40 CFR 258.74.)